

Message Text

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ACTION SS-30

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P 081330Z APR 74

FM AMEMBASSY KINGSTON

TO SECSTATE WASHDC PRIORITY 4442

INFO AMEMBASSY TUNIS PRIORITY

S E C R E T SECTION 1 OF 2 KINGSTON 1245/1

EXDIS

PASS TO OPIC

TUNIS FOR AMBASSADOR GERARD

E.O. 11652: GDS

TAGS: EFIN, EMIN, US, JA

SUBJECT: BAUXITE NEGOTIATIONS SITREP #30

HEREWITH THE TEXT OF THE NOTES USED BY LLOYD CUTLER IN
MAKING INDUSTRY'S PRESENTATION TO THE GOVERNMENT AT MEETING
APRIL 6.

BEGIN TEXT

NOTES FOR MEETING OF APRIL 6

THE CONSIDERATIONS EXPOUNDED IN THE CHAIRMAN'S LETTER
OF 3 APRIL RAISED IMPORTANT ISSUES OF GREAT ECONOMIC AND
FACTUAL COMPLEXITY. THE COMPANIES DISAGREE WITH MANY OF THE P
THE POSITIONS TAKEN, AND ARE NOW ENGAGED IN COMPILING AND
PREPARING THE DATA NECESSARY TO SUPPORT THEIR VIEWS- A TASK
WHICH CANNOT BE COMPLETED OVERNIGHT. MEANWHILE WE SUBMIT THE
FOLLOWING COMMENTS IN RESPONSE TO EACH POINT MADE
IN THE LETTER.

A. AT PRESENT RELATIVE PRICE LEVELS BETWEEN ALUMINUM
KHD COMPETING MATERIALS, WORLD DEMAND AND WORLD SUPPLY OF
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ALUMINUM ARE MORE NEARLY IN BALANCE THAN FOR MANY YEARS.

PRESENT ALUMINUM CAPACITY IS NOT YET FULLY EMPLOYED, AND DEMAND DOES NOT APPEAR TO BE GROWING AT AN APPRECIABLY HIGHER RATE THAN CAPACITY. MOREOVER, THE LUMINUM INDUSTRY IS A HIGHLY COMPETITIVE ONE, AND IN A COMPETITIVE INDUSTRY PERIODS OF BALANCE OR SHORTAGE INEVITABLY RESULT IN INDIVIDUAL COMPANY DECISIONS TO EXPAND PRODUCTION. PAST EXPERIENCE SHOWS THAT, IN AN INDUSTRY LIKE ALUMINUM WHERE CAPACITY CAN BE INCREASED ONLY IN LARGE UNITS AND NEW CAPACITY ONCE INSTALLED CANNOT BE LEFT IDLE, THE CUMULATIVE EFFECT OF INDIVIDUAL COMPANY DECISIONS TO EXPAND IS TO CREATE AN AGGREGATE CAPACITY AND PRODUCTION IN EXCESS OF DEMAND, AND A RESULTING DECREASE IN PRICES. SINCE THE MATERIALS AND SERVICES NECESSARY TO MAKE ALUMINUM ARE RELATIVELY PLENTIFUL, AND COMPETITIVE BEHAVIOR IS REQUIRED BY LAW IN THE MAJOR ALUMINUM MARKETS, THE COMPANIES HAVE SERIOUS DOUBT WHETHER THIS CYCLICAL PATTERN WILL CHANGE. THEREFORE, THE COMPANIES SEE CONSIDERABL BASIS FOR CONCERN THAT THE PRESENT SUPPLY-DEMAND BALANCE MAY NOT CONTINUE ANY LONGER THAN IT TAKES TO BUILD AND OPERATE SIGNIFICANT NEW ADDITIONS TO CAPACITY. AS ONE ILLUSTRATION, THE ALUMINA CAPACITY INCREASES THE JAMAICA NEGOTIATING TEAM HAS REQUESTED FROM THE COMPANIES, PLUS THE EXPANSION TENTATIVELY CONTEMPLATED BY REVERE, WOULD IF CARRIED OUT EXPAND THE UTILIZATION OF JAMAICA BAUXITE BY APPROXIMATELY 50 PERCENT OVER PRESENT LEVELS- A FIGURE WHICH IF DUPLICATED IN OTHER AREAS COULD BE EXTRA- POLATED TO A 50 PERCENT INCREASE IN WORLD ALUMINUM CAPACITY. THUS, THE NEGOTIATING TEAM'S OWN PROPOSALS SEEM INCONSISTENT WITH THE THEORY THAT DEMAND WILL BE INCGBASING AT TWICE THE RATE OF NEW CPAPACITY. ACCORDINGLY, THE PRESENT SUPPLY-DEMAND SITUATION TAKEN BY ITSELF, AFFORDS NO JUSTIFICATION FOR A MULTI-FOLD FIXED INCREASE IN THE ASSUMED VALUE OF JAMAICA BAUXITE OR ALUMINA OR IN JAMAICA'S TAX REVENUES FROM THESE PRODUCTS.

B. AS NOTED ABOVE, ALUMINUM IS A HIGHLY COMPETITIVE INDUSTRY, AND, BOTH INTERNALLY AND IN ITS BATTLE FOR MARKETS WITH OTHER MATERIALS, NO COMPANY HAS DISCRETIONARY POWER OVER THE PRICE OF ALUMINUM. NO COMBINATION OF COMPANIES MAY LAWFULLY EXERCISE SUCH POWER BY AGREEMENT UNDER THE LAWS OF ALUMINUM'S PRICIPAL MARKETS. THE PRICE FIGURES MENTIONED IN THE LETTER OF 3 APRIL ARE TRADE PRESS REPORTS OF "SPOT" PRICES QUOTED BY

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BROKERS OR OTHER NON-PRODUCERS FOR LIMITED QUANTITIES, AND ARE NOT REPRESENTATIVE OF THE CPRICES AT WHICH MOST OF WORLD PRIMARY ALUMINUM TRANSACTIONS ARE MADE. SUCH PRICES HAVE NEVER BEEN TYPICAL OF THE PRODUCING COMPAIES' AVERAGE REALIZED PRICES; THEY ARE WELL BELOW THE PRODUCTING COMPANIES' AVERAGE REALIZED PRICES WHEN MARKETS ARE SOFT, AND WELL ABOVE WHEN MARKETS ARE STRONG. IN ANY EVENT, TO WHATEVER EXTENT THE PRICE OF ALUMINUM MAY INCREASE ABOVE PRESENT LEVELS UNDER COMPETITIVE CONDITIONS

IN THE U.S. MARKET, TO WHICH MOST OF JAMAICA'S BAXUITE GOES, THE COMPANIES' PROPOSAL GUARANTEES A PROPORTIONATE INCREASE IN JAMAICA'S REVENUES.

C. WHILE OVERSUPPLY CONDITIONS IN THE ALUMINUM MARKET HAVE DEPRESSED ALUMINUM PRICES IN RELATION TO THOSE OF SOME COMPETING MATERIALS FOR THE PAST FIVE YEARS, IT REMAINS TRUE THAT EVEN AT PRESENT PRICES ALUMINUM COMPETES FOR SOME OF ITS PRINCIPAL MARKETS, SUCH AS CANS, PRIMARILY ON THE BASIS OF PRICE. IT IS ALSO TRUE THAT, COMPARED TO COSTS OF COMPETING MATERIALS, ALUMINUM COSTS, BEFORE THE HUGH TAX COST INCREASE JAMAICA NOW PROPOSES, HAVE RISEN PROPORTIONATELY AT LEAST AS MUCH AS THOSE OF COMPETING MATERIALS. IF ALUMINUM SUSTAINS HIGHER COST INCREASES AC THEREFORE MUST SELL AT CG PARATIVELY HIGHER PRICES THAN TINPLATE, FOR EXAMPLE, ALUMINUM COULD LOSE A VERY SUBSTANTIAL PART OF ITS TOTAL MARKET - IN THE RANGE OF 10 PERCENT - TO TINPLATE. SUCH A LOSS WOULD TURN THE PRESENT SUPPLY BALANCE INTO A RPPLY SURPLUS AND THIS SURPLUS WOULD WEAKEN U.S. ALUMINUM PRICES FOR THE REMAINING 90 PERCENT OF ITS MARKETS, THUS FURTHER IMPAIRING THE INDUSTRY'S ABILITY TO PAY THE ADDITIONAL REVENUES THE GOVERNMENT PROPOSES.

D. IT IS TRUE THAT THE EFFECT OF A JAMAICA REVENUE INCREASE OF US\$2.50 PER TON OF AUXITE, IF PASSED THROUGH TO THE PRICE OF PRIMARY ALUMINUM, WOULD NOT ITSELF INCREASE THAT PRICE BY MORE THAN SOMEWHAT OVER 1/2 CENT PER POUND. (THE NEGOTIATING TEAM'S PROPOSAL, OF COURSE, IS MANY TIMES US\$2.50.) BUT FOR THE REASONS NOTED IN PARAGRAPH C, AND THE FURTHER REASON THAT MOST ALUMINUM IS FIRST SOLD IN FABRICATED RATHER THAN PRIMARY FORMS IN MARKETS EACH SUBJECT TO THEIR OWN PARTICULAR COMPETITIVE PRESSURES, IT MAY WELL BE IMPOSSIBLE FOR ANY COMPANY TTVPASS ALONG THE COST OF MAJOR INCREASE IN JAMAICA

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REVENUE COSTS. WHILE NO COMPANY IS ABLE TO PREDICT FUTURE PRICES, IT IS FAR FROM CERTAIN THAT THE AVERAGE PRICES THAT WOULD PREVAIL IN COMPETITIVE AND UNCONTROLLED MARKETS, IN WHICH ALUMINUM COMPANIES COMPETES ITH ONE ANOTHER AND WITH THE PRODUCERS OF RIVAL MATERIALS, WOULD EXCEED THE ADDITIONAL COST INCREASES THAT MAY REASONABLE BE ANTICIPATED IN THOSE MARKETS (E.G., THE COST-OF -LIVING ESCALATION REQUIRED BY EXISTING WAGE AGREEMENTS), EVEN BEFORE THE LARGE FIXED REVENUE COST INCREASES JAMAICA NOW PROPOSES. IN THE COMPANIES' VIEW, ANYTHING APPROACHING THE SHARP RISE IN FIXED REVENUE COSTS PER TON OF BAUXITE PROPOSED BY THE NEGOTIATING TEAM WOULD VIRTUALLY WIPE OUT THE MODEST RATE OXM PROFIT THE MORE SUCCESSFUL COMPANIES NOW EXPERIENCE, EITHER BECAUSE AN ATTEMPTED PASS-ALONG OF THIS INCREASED COST TO

CUSTOMERS WOULD RESULT IN A MEJOR LOSS EXISTING OR POTENTIAL
MARKETS, OR BECAUSE THE ABSORPTION OF THIS INCREASED COST IN
ORDER TO REMAIN COMPETITIVE WOULD CURTAIL EVEN THE PRESENT
SOW PROFIT MARGINS. HEWITT

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ACTION SS-30

INFO OCT-01 ISO-00 /031 W

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P 081340Z APR 74

FM AMEMBASSY KINGSTON

TO SECSTATE WASHDC PRIORITY 4443

INFO AMEMBASSY TUNIS PRIORITY

S E C R E T SECTION 2 OF 2 KINGSTON 1245/2

EXDIS

PASS TO OPIC

UNDER THE COMPANIES' PROPOSAL, PRESENT TAX AND ROYALTY
PAYMENTS TO JAMAICA IN 1974 WOULD RISE BY AN ANNUALIZED RATE
OF 80 PERCENT (AT AN ALUMINUM PRICE OF 29 CENTS PER POUND)
OVER THE AMOUNT PAYABLE AT THE PRESENT ROYALTY AND TAX
RATES, AND PERHAPS SUBSTANTIALLY MORE (DEPENDING ON THE U.S.
MARKET PRICE OF PRIMARY ALUMINUM). (E.G., 94 PERCENT AT
33 -1/2 CENTS A POUND) MOREOVER, THE COMPANIES' PROPOSAL ALSO
ADDRESSES ITSELF TO A POINT THE NEGOTIATING TEAM HAS STRESSED
AS CENTRAL-THE FAIR VALUE OF JAMAICA BAUXITE IN RELATION TO THE
PRICE OF PRIMARY ALUMINUM. JAMAICA BAXUITE MUST OF COURSE
REMAIN COMPETITIVE WITHOTHER EXISTING AND POTENTIAL SOURCES FOR
ALUMINUM BEARING RAW MATERIALS. AS THE NEGOTIATING TEMA
KNOWS, THE U.S. TREASURY, APPLYING TO JAMAICA BAUXITE THE
ARM'S LENGTH CRITERIA OF U.S.LAW AND THE DOUBLE TAXATION
TREATY, AND EXAMINING THE PRICES IN THE FEW KNOWN TRANSACTIONS
FOR COMPARABLE QUANTITIES OVER COMPARABLE PERIODS, HAS NOT
BEEN WILLING TO ACCEPT A VALUE AS OF THE 1969 REFERENCE DATE
GREATER THAN APPROXIMATELY 8 PERCENT OF THE PRIMARY
ALUMINUM PRICE AT THT TIME. UNDER THE COMPANIES' PROPOSAL,
THE ISSUE OF WHETHER BAUXITE TRANSFER PRICES FOR INCOME TAX
PURPOSES (E.G., THE ESTIMATED VALUE OF JAMAICA BAUXITE IN ARM'S
LENGTH TRANSACTIONS BETWEEN INDEPENDENT TNTITIES) SHOULD
REPRESENT A LARGER PROPORTIONATE SHARE OF THE WORLD PRICE

OF ALUMINUM THAN AT PTRSENT COULD BE SUBMITTED PERIODICALLY
TO BINDING ARBITRATION, AND IF AJAMAICA SHOUD PREVAIL,
JAMAICA'S INCOME TAX REVENUES WOULD INCREASE ACCORDINGLY

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NOW THAT THE GOVERNMENT HAS ARTICULATED ITS FOUR
BASIC ECONOMIC CONSIDERATIONS, THE COMPANIES ARE
ACTIVELY ENGAGED IN PREPARING DETAILED ECONOMIC
AND FINANCIAL DATA DATA WHICH WILL SUPPORT THE
ABOVE POSITIONS. SOME OF THIS DATA IS BEING COMPILED FROM
PUBLISHED SOURCES AND CAN BE PRESENTED ON AN INDUSTRY-WIDE
BASIS; THE REMAINDER IS CONFIDENTIAL AND WILL HAVE TO BE
PROVIDED ON A COMPANY-BY-COMPANY BASIS (ACCOMPANIED WHERE FEASIBLE
BY INDUSTRY AVERAGES COMPILED BY INDEPENDENT COUNSEL BASED
ON INDIVIDUAL COMPANY DATA FURNISHED TO COUNSEL ON A CONFIDENTIAL
BASIS). WE HOPE TO PRESENT THIS DATA WITHIN TWO WEEKS. DURING
THIS PERIOD, WE WOULD ALSO LIKE TO EXAMINE ANY DATA
COMPILED BY THE NEGOTIATING TEAM IN SUPPORT OF THE PSITIONS
SET FORTH IN ITS LETTER OF 3 APRIL. WE WOULD FURTHER
SUGGEST THAT IN THE WEEK BEGINNING 22 APRIL A SERIES OF MEETINGS
BE HELD TO COMMENT ON THE DATA PRESENTED ON EACH SIDE
AS A BASIS FOR ARRIVING AT A MUTUALLY AGREEABLE
REVISION OF THE PRESENT CONTRACTUAL ARRANGEMENTS.
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